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In Our Opinion.....

The Newsletter of the AICPA Audit and Attest Standards Group

Vol. 20 No. 3

Summer 2004

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ASB Issues New Interpretations of SAS No. 58

The Auditing Standards Board has issued two new interpretations of SAS No. 58 *Reports on Audited Financial Statements* (AU sec. 508). Interpretation No. 17 provides illustrative language in the auditor's report to clarify that an audit performed in accordance with generally accepted auditing standards (GAAS) does not require the same level of testing and reporting on internal control over financial reporting as an audit of an issuer for whom Section 404(a) of the Sarbanes Oxley Act of 2002 is applicable. Interpretation No. 18 clarifies the applicability of GAAS and provides illustrative language for a dual reference reporting situation in which the audit was conducted in accordance with GAAS and also in accordance with the auditing standards of the Public Company Accounting Oversight Board. These interpretations are available at <http://www.aicpa.org/members/div/auditstd/announce/index.htm>

Auditing the Statement of Social Insurance

by Judith M Sherinsky

The Auditing Standards Board is about to issue a Statement of Position (SOP) titled *Auditing the Statement of Social Insurance* to assist CPAs in auditing this financial statement required by Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standards (SFFAS) No. 17, *Accounting for Social*

*Insurance, and No. 25, Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*¹.

An example of a social insurance program is Social Security for which the statement of social insurance covers a period of 75 years in the future. In summary, a statement of social insurance is a long-term projection of the present value of the income to be received from or on behalf of existing and future participants of social insurance programs, the present value of the benefits to be paid to those same individuals, and the difference between the income and benefits. Future participants are individuals expected to become participants and may include individuals who have not yet been born. Preparing a statement of social insurance requires that management of the agency develop estimates using legal, economic, and demographic information, and the assistance of specialists, such as actuaries.

The Auditing Standards Board issued an exposure draft of the proposed SOP in March 2004 which has since been revised to:

- More clearly describe the auditor's responsibility with respect to work performed and findings reported by external review groups. (An example of an external review group is the board of trustees established by the Social Security Act to oversee the financial operations of the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund.)
- No longer dissuade auditors from issuing a qualified opinion on the statement social insurance, when warranted. (The exposure draft recommended that the auditor generally issue an adverse or disclaimer of opinion if he or she could not express an unqualified opinion.)
- Reflect the requirement that the agency disclose the significant assumptions used in preparing the estimates currently in proposed SFFAS, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*.¹
- Provide procedural guidance to the auditor when controls over the agency's estimation process are ineffective
- State that it may not, rather than would not, be appropriate to establish a single materiality threshold for the entire set of financial statements and that the auditor should consider using a separate materiality level for the statement of social insurance.
- Indicate that if the actuary who has prepared or reviewed the actuarial valuation of the social insurance program was engaged by the agency administering that program, the auditor must obtain the services of an independent actuary to assist in performing auditing procedures to assess the agency actuary's methods, assumptions, and estimates, and aid the auditor in determining whether the agency actuary's findings are not unreasonable in the circumstances.

¹ A new proposed Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standards, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*, was being balloted for issuance as a final standard at the date of this newsletter.

- Refer the reader to *Government Auditing Standards* for independence requirements and examples of personal, external, and organizational impairments to independence.
- Include certain documentation requirements regarding audit procedures performed with the assistance of an independent actuary.

The exposure period for the SOP was extended until May 3, 2004 to provide affected agencies with additional time to consider the provisions of the proposed SOP and provide comments on them. An important aspect in developing the SOP was the input, prior to and after exposure of the SOP, from representatives of various agencies that prepare statements of social insurance. At a meeting in July 2004 with representatives of the U.S. Government Accountability Office (GAO) it was noted that financial reporting and auditing of social insurance are developing areas of practice. The GAO representatives recommended that the Social Insurance Task Force monitor and consider feedback from auditors and users of statements of social insurance. As these groups gain additional experience in implementing the SOP, the task force will consider whether additional or revised guidance on this subject matter is needed.

The effective date for the SOP is for periods beginning after September 30, 2005. The SOP will be available in October 2004.

ARSC Issues Revised Illustrative Representation Letter for Review Engagements

by Michael Glynn

The Accounting and Review Services Committee has issued a revised illustrative representation letter for review engagements performed under Statements on Standards for Accounting and Review Services. The revised letter:

- Clarifies how a representation letter should be dated.
- Clarifies the meaning of the terms *identification of financial statements*, *dates*, and *periods of review*, as they are used in the opening paragraph of the illustrative representation letter.
- Clarifies that representations should be made as of the date of the accountant's review report.
- Includes representations regarding fraud that are now required by Statement on Standards for Accounting and Review Services No. 10, *Performance of Review Engagements*.
- Includes an additional representation regarding the client's acceptance of proposed adjusting journal entries, if any.

The revised illustrative representation letter for review engagements is available at http://www.aicpa.org/members/div/auditstd/Revision_of_Appendix_F.htm

SAS No. 70 Reports Issued by Non-CPAs

The requirement that public companies undergo an audit of their internal control as well as an audit of their financial statements has led to greater interest in engagements performed under Statement on Auditing Standards (SAS) No. 70, *Service Organizations*. SAS No. 70 provides guidance to service auditors who perform and report on a service auditor's engagement, and to user auditors who use a service auditor's report in an audit of financial statements.

A service organization is an entity that performs a service for user organizations that results in information to be included in the user organizations' financial statements. An example of a service organization is the trust department of a bank that holds and services securities for other entities. Information about the purchase and sale of securities, receipt of interest and dividends, and payment of fees is reported to user organizations and included in their financial statements. (For additional information about service organizations, see the AICPA May 2004 Audit Guide, *Service Organizations, Applying SAS No. 70, As Amended* (product no.012774).

It has come to the AICPA's attention that in some cases, service auditors' engagements are being performed and reported on by consulting organizations that are not licensed CPA firms. SAS No. 70, which is part of generally accepted auditing standards, is intended for use by licensed CPAs. For a user auditor to use a service auditor's report, it must be issued by a licensed CPA. CPAs may not use a report provided by an unlicensed individual or entity. User auditors should be alert to the possibility that a service auditor's report may not have been prepared by a licensed CPA and should consider contacting a representative of an unfamiliar organization to verify that the organization is properly licensed, peer reviewed, and able to provide its peer review report and letter of comments and response. If the organization is unlicensed, CPAs are advised to convey that finding to the state board of accountancy in the state in which the engagement was performed or to their own state board.

Check 21 Act: Paper Reproductions of Checks May Warrant Change in Audit Procedures

The Check Clearing for the 21st Century Act gives *substitute checks* the same legal validity as the original paper checks. Substitute checks are paper reproductions of checks that include an image of the front and back of the original check, and can be processed just like the original check. The Act is intended to reduce the check payment system's dependence on the physical transportation of checks and to streamline the collection and return process. The Act becomes effective on October 28, 2004.

The use of copies of checks instead of the originals means banks no longer have to transport checks throughout the country, and consumers (including business clients) may receive copies of their cancelled checks rather than cancelled paper checks. Although compliance with the Act is voluntary, most banks are expected to comply because of the significant cost savings for them. The Act specifically states that

substitute checks provided by the bank to its customers have all the force and effect of the actual cleared check.

In planning audit engagements, auditors should be aware of the Act and consider how it may affect the nature, timing, and extent of their audit procedures, especially if the misappropriation of cash is identified as a high fraud risk. Additional information about the Act is available at the following Web site: <http://www.federalreserve.gov/paymentsystems/truncation/default.htm>.

The Forensic Accountant's Role in an Audit of Financial Statements

In audits conducted in accordance with generally accepted auditing standards, as well as those conducted in accordance with standards of the Public Company Accounting Oversight Board, the auditor must plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement, including material misstatements caused by fraud. The Sarbanes-Oxley Act of 2002 makes audit committees of issuers (publicly-traded companies) responsible for the appointment, compensation, and oversight of independent auditors; for establishing a system for the receipt, retention, and treatment of complaints received by issuers; and for hiring advisers to carry out the audit committee's duties. An example of such an adviser is the forensic accountant who assists audit committees and CPAs in carrying out their responsibilities related to fraud. Forensic accounting may involve expertise in areas such as accounting, auditing, finance, quantitative methods, law, research, and investigation for the purpose of collecting, analyzing, and evaluating evidence and interpreting and communicating findings.

Many of the suggested procedures in Statement on Auditing Standards (SAS) No. 99, *Consideration of Fraud in a Financial Statement Audit*, are forensic in nature. Paragraph 50 of SAS No. 99 states in part:

... the auditor may respond to an identified risk of material misstatement due to fraud by assigning additional persons with specialized skill and knowledge, such as forensic and information technology (IT) specialists, or by assigning more experienced personnel to the engagement.

In a forensic engagement, the accountant presumes that management may be dishonest and may have overridden controls, falsified documents, and colluded with others. Examples of forensic procedures include interviews of financial and nonfinancial personnel in greater depth or breadth than is customarily the case, unannounced recounts of inventory, and tests of accounts traditionally deemed low risk.

The AICPA's Forensic and Litigation Services (FLS) Committee has issued a discussion memo titled "Forensic Services and Corporate Governance: Bridging the Gap" in an effort to gather information that will assist in the development of guidance for CPAs who provide forensic services. Such guidance also is expected to be useful to external auditors, internal auditors, corporate management, directors responsible for corporate governance, and other groups interested in improving financial reporting. The discussion

memo seeks responses to questions about forensic services. The FLS plans to use this information to develop guidance. In addition, the discussion memo includes the FLS's initial observations and views concerning forensic accountants' services, including involvement with independent audit teams to increase financial statement audit effectiveness in applying SAS No. 99, and performing accounting-related fraud investigations. The discussion memo can be accessed at: http://www.aicpa.org/download/mcs/2004_07_Forensic_Audit_Paper.pdf

Highlights of Technical Activities

The Auditing Standards Board (ASB) performs its work through task forces composed of members of the ASB and others with technical expertise in the subject matter of the projects. The findings of these task forces periodically are presented to members of the ASB at public meetings for their review and discussion. Listed below are the current task forces of the ASB and brief summaries of their objectives and activities.

Task Forces of the ASB

AT 501 Reporting on Internal Control Task Force (Staff Liaison: Judith M. Sherinsky; Task Force Chair: Michael T. Umscheid). The AT 501 Internal Control Task Force will be revising AT 501, *Reporting on an Entity's Internal Control Over Financial Reporting*, and SAS NO 60, *Communication of Internal Control Related Matters Noted in an Audit*. Some of the matters the task force will consider in revising AT 501 are:

- Comments received on the exposure draft of the proposed Statement on Standards for Attestation Engagements, *Reporting on an Entity's Internal Control Over Financial Reporting*, which was issued in March 18, 2003.
- PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*.
- The views of insurance companies, financial institutions, and the U.S. Government Accountability Office which use AT 501 to report on internal control.

Audit Documentation (Staff Liaison: Sharon Walker; Task Force Chair: Lynford E. Graham). This task force is considering revisions to SAS No. 96, *Audit Documentation*. At the June 2004 ASB meeting, the task force presented a revised draft of SAS No. 96 that responded to the ASB's May 2004 recommendations. After discussion of the task force's proposed revisions, the ASB directed the task force to base the structure and language of the revised standard on the International Auditing and Assurance Board's exposure draft of ISA 230, *Audit Documentation*, and to include in the standard the guidance in Public Company Accounting Oversight Board Auditing Standard No. 3, *Audit Documentation*, that is not contained in ISA 230 and is applicable and appropriate for audits of nonissuers. The task force will present a revised draft of the proposed standard at the September 2004 ASB meeting.

Audit Issues Task Force (Staff Liaison: Sharon Walker; Task Force Chair: John A. Fogarty). This task force (1) oversees the ASB's planning process, (2) evaluates technical issues raised by various constituencies and determines their appropriate disposition including referral to an ASB task force or development of an interpretation or other guidance, (3) addresses emerging audit and attestation practice issues, (4) provides advice on ASB task force objectives and composition, and monitors the progress of task forces, and (5) assists the chair of the ASB and the Audit and Attest Standards staff in carrying out their functions, including liaising with other groups. The AITF will hold its next meeting on September 30, 2004 in Atlanta.

Auditors' Reports Task Force (Staff Liaison: Sharon Walker; Task Force Chair: Harold L. Monk). This task force is revising SAS No 58, *Reports on Audited Financial Statements* (AU sec. 508), in light of the International Auditing and Assurance Standards Board's recently exposed International Standard on Auditing, *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*, and PCAOB Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the PCAOB*. The ASB believes that it is appropriate and timely to revisit the required reporting elements and the language in the auditor's report for audits of nonissuers. The ASB further believes that clarifying certain aspects of the report will help to narrow the expectation gap.

Internal Control Reporting Task Force (Staff Liaison: Judith M. Sherinsky; Task Force Chair: Garrett L. Stauffer). The task force plans to meet on a weekly basis to further discuss implementation issues related to Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*, which was issued by the Public Company Accounting Oversight Board in March 2004. The standard establishes requirements that apply when an auditor is engaged to audit both an issuer's financial statements and management's assessment of the effectiveness of internal control over financial reporting as required by Section 404 of the Sarbanes-Oxley Act. Most recently, the task force has been developing guidance for evaluating the severity of control deficiencies, including deficiencies in general computer controls.

International Auditing Standards Subcommittee (Staff Liaison: Sharon Walker; Subcommittee Chair: William F. Messier). The objective of this subcommittee is to support the development of international auditing standards. Subcommittee activities include providing technical advice and support to the AICPA representative and technical advisors to the International Auditing and Assurance Standards Board, commenting on exposure drafts of international assurance standards, participating in and identifying U.S. volunteer participants for international standard-setting projects, identifying opportunities for establishing joint standards with other standard setters, identifying international issues that affect auditing and attestation standards and practices, and assisting the ASB and other AICPA committees in developing and implementing AICPA international strategies.

Joint Quality Control Standards Task Force (Staff Liaison: Judith M. Sherinsky; Task Force Chair: Craig W. Crawford). The task force considers matters related to Statements on Quality Control Standards (SQCSs). The task force has completed its revision of *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, which will be available in the form of a practice aid in October 2004.

Risk Assessments Task Force (Staff Liaisons: Hiram Hasty; Task Force Chairs: Darrel R. Schubert and John A. Fogarty). At a meeting on May 19, 2004, the task force developed a plan for finalizing the seven proposed Statements on Auditing Standards (SASs) related to the auditor's risk assessment process that were exposed for comment in December 2002. That exposure draft was a joint effort of the International Auditing and Assurance Standards Board (IAASB) and the ASB. At its June 22-23, 2004 meeting, the ASB approved the task force's plan to finalize the exposure drafts. The task force is considering the following sources in finalizing the standards:

- The comment letters on the exposure drafts of the seven proposed risk assessment SASs.
- A proposed auditing standard issued by the Public Company Accounting Oversight Board titled *Conforming Amendments to PCAOB Interim Standards Resulting From Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*, that may warrant conforming changes to the SASs.
- Changes made by the IAASB to the risk assessment exposure drafts to reflect the final standards issued by the IAASB in October 2003.

The task force will revise the exposure drafts and present them to the ASB for discussion at the September 28-30, 2004 and December 14-16, 2004 meetings. In the Spring of 2005, the ASB expects to vote to issue the final standards which will be effective for audits beginning after December 2005. To assist auditors in implementing these new standards, the task force recommended that an audit guide be simultaneously issued with the final standards.

Legal Inquiry Letters Reeducation Task Force (Staff Liaison: Hiram Hasty; Task Force Chair: Susan L. Menelaides). This joint task force, composed of representatives of the AICPA and the American Bar Association, was established to address concerns regarding language used by auditors in audit inquiry letters issued pursuant to SAS No. 12, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, and responses by attorneys to those letters.

Social Insurance Task Force (Staff Liaison: Judith M. Sherinsky, Task Force Chair: Pat McNamee). The task force has completed its work on the proposed Statement of Position, *Auditing the Statement of Social Insurance*. See the article on page 1, "Auditing the Statement of Social Insurance," for information about the SOP.

Using the Work of a Specialist Task Force (Staff Liaison: Hiram Hasty; Task Force Chair: Michael T. Umscheid). This task force is revising Statement on Auditing Standards (SAS) No. 73, *Using the Work of a Specialist*, and is considering replacing it with two new SASs. One of the proposed SASs, *Using an Outside Specialist to Assist in the Audit*, would address situations in which an auditor engages an outside (non-firm) specialist to provide specialized skills or knowledge needed in the audit, but not available on the engagement team. The other proposed SAS, *Using the Work of Management's Nonemployee Specialist*, would focus on situations in which an auditor uses as audit evidence the work product of a nonemployee specialist hired by management. At its February and June 2004 meetings, the ASB discussed the task force's recommendations for changes to SAS No. 73. Revised drafts of the proposed standards will be presented at the ASB's September 2004 meeting.

Other Activities

Accounting and Review Services Committee (ARSC) (Staff Liaison: Michael Glynn; Committee Chair: Andrew M. Cohen). The ARSC is the senior technical committee of the AICPA designated to issue pronouncements in connection with the unaudited

financial statements or other unaudited financial information of nonpublic entities. The charge of the ARSC is to develop and communicate, on a continuing basis, comprehensive performance and reporting standards as well as practice guidance that enables practitioners to provide high quality, objective, compilation and review services that serve the profession, clients, and the general public. The ARSC accomplishes this objective by developing compilation and review standards, timely responding to the need for guidance, and clearly communicating such guidance to the profession and users of financial statements. The ARSC recently developed an illustrative representation letter for review engagements which is described on page 3 in the article "ARSC Issues Revised Illustrative Representation Letter." The ARSC will hold its next meeting in Nashville, TN on November 1-2, 2004.

Anti-Fraud Task Force (Staff Liaison: Michael Glynn; Task Force Chair: Ronald L. Durkin). The Anti-Fraud Task Force is charged with further developing the specificity of management anti-fraud programs and controls criteria as introduced in the document, *Management Antifraud Programs and Controls: Guidance to Help Prevent, Deter, and Detect Fraud*, issued jointly by several organizations, including the AICPA. The task force is currently developing a document intended to provide guidance to audit committees to assist them in addressing the risk of fraud through management override of internal control. The task force will hold its next meeting in New York on October 27, 2004.

Auditing Standards Committee of the American Accounting Association (AAA) (Chair: Dana Hermanson, Kennesaw State University; ASB/AICPA Liaisons to the Committee: William Messier and Michael Glynn). The Auditing Standards Committee of the AAA is charged with fostering interaction between the AAA's Auditing Section and auditing standard-setting bodies such as the AICPA's ASB. The ASB supports strengthening its relationship with the academic community as well as increasing the community's participation in the standard-setting process.

International Auditing and Assurance Standards Board (IAASB) (U.S. Member: John A. Fogarty; U.S. Technical Advisor: Susan S. Jones). The IAASB met in June 2004 in Copenhagen. At its June meeting, the IAASB voted to issue as a final standard, a new International Standard on Auditing (ISA), which establishes standards and provides guidance on the considerations and activities applicable to planning an audit of financial statements. The IAASB also continued its work on proposed standards on the auditor's report, documentation, group audits, reports on special purpose audit engagements, materiality, and the clarity of the IAASB pronouncements. Copies of IFAC's final auditing, assurance, related services, and quality control standards can be found at: <http://www.ifac.org/Guidance/>.

The 2005 adoption in the European Union of the International Financial Reporting Standards (IFRSs), and the adoption of IFRSs in other countries, has given rise to requests for various forms of auditor's reports on related financial information, including the IFRS opening balance sheet. In response to such requests, the staff of the IAASB has issued nonauthoritative guidance on the first time adoption of IFRS. This document can be found at the following web site: <http://www.ifac.org/News/LastestReleases.tmp?NID=10942457962978354>.

Professional Issues Task Force (PITF) (Staff Liaison: Michael Glynn; Task Force Chair: Charles J. McElroy). The PITF is responsible for accumulating and considering

practice issues that appear to present concerns for practitioners performing audits and reviews of financial statements or agreed-upon procedures engagements under the attestation standards. The PITF also is responsible for disseminating information or guidance, as appropriate, in the form of practice alerts. Practice alerts are intended to provide practitioners with information that may help them improve the effectiveness and efficiency of their engagements and practices, and are based on existing professional literature, the experience of the members of the PITF, and information provided by AICPA member firms to their own professional staffs. The task force also refers matters that may require reconsideration of existing standards to the appropriate standard-setting bodies. All alerts that have not been superceded are available at http://www.aicpa.org/members/div/auditstd/pract_alerts.asp. In addition, the alerts are published annually in the AICPA Technical Practice Aids.

Recently Issued and Approved Documents

Interpretations of Statements on Auditing Standards (SASs)	
Title	Issuance Date*
<p><u>Interpretations of SAS No. 58, <i>Reports on Audited Financial Statements</i> (AU sec. 508)</u></p> <p>Interpretation No.17. "Clarification in the Audit Report of the Extent of Testing of Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards" (AU sec. 9508.85-.88)</p> <p>Interpretation No. 18. "Reference to PCAOB Standards in an Audit Report on a Nonissuer" (AU sec. 9508.89 - .92)</p>	<p>June 2004</p> <p>June 2004</p> <p>*The issuance date of interpretations of auditing standards is the first date that the document is made widely available to the public. In most cases, this will be the date the document is posted to the Web site: www.aicpa.org There may be cases in which the document is first made widely available in hard copy, or published in the <i>Journal of Accountancy</i>. In those cases, the publication date of the document is considered to be the date of publication of the hard copy, or the date of publication in the <i>Journal of Accountancy</i>.</p>

Statements on Standards for Accounting and Review Services (SSARS)		
Title (Product Number)	Issue Date	Effective Date
SSARS No. 10, <i>Performance of Review Engagements</i> (060663)	May 2004	Effective for reviews of financial statements for periods ending on or after December 15, 2004. Earlier application of the provisions of this Statement is permitted.
SSARS No. 11, <i>Standards for Accounting and Review Services</i> (060710)	May 2004	Effective upon issuance.

Interpretations of Statements on Standards for Accounting and Review Services (SSARS)	
Title	Issuance Date*
<u>Interpretation of SSARS No. 1, <i>Compilation and Review of Financial Statements</i></u> Interpretation No. 26, "Communicating Possible Fraud and Illegal Acts to Management and Others"	May 2004 *The issuance date of interpretations of accounting and review services standards is the first date that the document is made widely available to the public. In most cases, this will be the date the document is posted to the Web site: www.aicpa.org . There may be cases in which the document is first made widely available in hard copy, or published in the <i>Journal of Accountancy</i> . In those cases, the publication date of the document is considered to be the date of publication of the hard copy, or the date of publication in the <i>Journal of Accountancy</i> .

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Projected Auditing Standards Board Agenda

Codes: DI- Discussion of issues, DD - Discussion of draft document, ED-Vote to ballot a document for exposure, EP-Exposure Period, CL- Discussion of comment letters, FI-Vote to ballot a document for final issuance, SU- Status Update; NC-Negative Clearance

Project	September 28-30, 2004 Atlanta, GA
AT 501, Reporting on Internal Control	DI
Audit Documentation	DD
International Auditing Standards Subcommittee	SU
Risk Assessment	DD
Using the Work of Specialists	DD

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